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**MEMORANDUM OF LAW**

**DATE:** May 16, 2000

**TO:** Mike Bresnahan, Assistant Deputy Director

**FROM:** City Attorney

**SUBJECT:** Whether Water Department is Required to Pay Customers Interest Earned on Guarantee Deposits

**QUESTION PRESENTED**

You have asked for a legal opinion on whether the Water Department is legally obligated to pay its customers interest on the guarantee deposits that some customers are required to pay to set up a new water account.

**SHORT ANSWER**

The Water Department has no legal obligation to pay its customers interest on their guarantee deposits.

**ANALYSIS**

The Water Department requires a guarantee deposit as a condition of setting up a new water account from customers who have no previous account history with the Department, or who have a history of delinquent payments on previous accounts. San Diego Municipal Code § 67.23. The deposit is to ensure that the Department is paid for the water service that it provides. Most customers who provide a deposit are entitled to a refund of the deposit after twelve months of timely payments. San Diego Municipal Code § 67.29. The deposit funds are kept in an account which earns interest, and all of the interest earned on the deposit funds is

retained by the Department. Recently, a customer has asked the Department for interest on the deposit that the customer provided to set up an account.

There are no California statutes or cases which discuss the specific issue of whether a utility such as the Water Department must pay interest to customers on their guarantee deposits. However, one California court has ruled, in a similar situation, that a landlord has no legal obligation to pay a tenant interest on a rental security deposit. *Korens v. R.W. Zukin Corp.*, 212 Cal. App. 3d 1054 (1989).

In the *Korens* case, a class action lawsuit was brought by a group of past and present tenants of the defendant property owner to recover interest earned on their security deposits. The plaintiffs argued that the defendant's failure to pay interest on the deposits constituted an unfair business practice, breach of an implied term of their rental contracts, breach of the implied covenant of good faith and fair dealing, and fraud. *Id.* at 1057. The plaintiffs argued that when security deposits are provided to a landlord, a trust is created which obligates the landlord, as trustee, to pay interest to the tenant.

The court disagreed, holding that the payment of a security deposit creates only a debtor-creditor relationship, not a trust relationship. *Id.* at 1058. In the absence of a statute mandating the payment of interest in a specific situation, or an express contract provision, the court held that a debtor-creditor relationship alone does not require payment of interest on a deposit. *Id.* at 1061. The fact that the landlord had earned interest on the security deposits collected from the tenants was found to be irrelevant to the issue of whether the landlord had an obligation to pay interest to the tenants. *Id.* at 1063, fn. 2.

The reasoning in the *Korens* case is applicable to the Water Department and its customers who provide guarantee deposits. The Department requires guarantee deposits from its customers to ensure that it is paid for the water service that is provided. No state law requires a utility to pay its customers interest on their deposits, and no state law prohibits the Department from placing the deposit funds in interest earning accounts. The Department has no contract with its customers that requires interest to be paid on the deposit. Like the landlord-tenant relationship, the Department's relationship with its customers is a debtor-creditor relationship. Based on these similarities with the landlord-tenant relationship, the Department has no legal obligation to pay its customers interest on their deposits.

Mike Bresnahan

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May 16, 2000

If you want to discuss this matter further, or have additional questions, please feel free to contact me.

CASEY GWINN, City Attorney

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By

Lisa A. Foster  
Deputy City Attorney

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